No. 5874

IN THE

United States Circuit Court of Appeals

IN AND FOR THE NINTH JUDICIAL CIRCUIT IN EQUITY

CHARLES A. BURCKHARDT,

vs.

NORTHWESTERN NATIONAL BANK, et al.,

Respondents.

FRED A. BALLIN,

Appellant,

vs.

THE NORTHWESTERN NATIONAL BANK, et al.,

Respondents.

Brief of Respondents

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STATEMENT OF THE CASE

A statement of the case is deemed necessary by respondents for the reason that the statement made by appellants is not understandable. The case is made by the pleadings, of which no mention is made by appellants, and of which a synopsis is necessary to clarity of approach.

Northwestern National Bank of Portland (Oregon) being in liquidation at the time these suits were instituted, was demanding payment of certain obligations due it from appellants, who, as well as being debtors were stockholders of the bank. In part at least to prevent the collection of their indebtedness the appellants instituted these suits against the bank, its directors, and a former director, in which suits certain charges were made and certain relief prayed for.

The bills of complaint are replete with innuendo, but we believe it to be fair to say that the actual charges contained therein are the following and no others:

1. That between July 2, 1922, and December 31, 1926, the defendant directors knowingly and willfully caused to be lost to the bank $2,315,000.00, an aggregate sum composed of sixteen items separately enumerated in the complaint.

2. That in violation of the mandate of the National Bank Examiner that certain loans grouped under the generic designation of the "Wheeler lines" be reduced, the directors knowingly and willfully caused said loans to be lost to the bank.

3. That in violation of the National Banking Act the directors caused to be loaned to J. E. Wheeler $634,000.00, being an excess over thirty per cent of the capital of the association and consequently a loan prohibited by statute.

4. That in 1927 the defendant directors "allowed and permitted" the bank to get into financial difficulties and involve the stockholders in loss by arranging with the United States National Bank and the First National Bank (both of Portland) for these institutions to take over the assets of the Northwestern National Bank, assume its deposit liabilities, and for the latter to discontinue the banking business.

These charges were categorically denied in the several answers filed by the defendant directors, except the defendant, Olmstead, who is not represented by the

counsel making a joint appearance for all of the other defendants. It will be shown that the evidence failed to establish the charges made in the bills of complaint.

With respect to the first of these charges, it was established by the evidence that the loans under criticism were intelligently and carefully made, and that in so far as losses resulted therefrom, such losses are attributable to lessened financial responsibility of the borrowers over which the directors had no control, rather than to derelictions of duty on the part of the directors in the attempted collection of the debts.

With respect to the second charge, the evidence establishes the fact that the loans made to the "Wheeler lines" were justified by proper banking practice, were adequately secured, and were to a large degree, if not entirely, actually collected.

With respect to the third charge that loans in excess of the statutory limit were made, there could not be and was no evidence offered in support.

With respect to the fourth charge relating to the financial difficulties in which the bank became involved, growing out of which came the transfer of its assets to and the assumption of its deposit liabilities by the United States National Bank and the First National Bank, it was established by the evidence that none of the directors except Olmstead had knowledge of any acute or dangerous condition in the affairs of the bank until February, 1927. That forthwith upon such knowledge being acquired immediate action was taken to correct the situation by the directors making immediately

available for use by the bank funds sufficient in amount to place it in the strongest financial condition in which it had been for years, under conditions which insured such funds later becoming permanently incorporated into the capital of the bank. That in spite of this action on the part of the directors rumors involving the soundness of the institution became current in the community, the effect of which rumors the directors, in spite of aggressive efforts on their part, were unable to counteract. That a run was precipitated upon the institution which necessitated transfer of its assets to the United States National Bank and the First National Bank under conditions creditable to the wisdom, the courage and the sense of responsibility of the directors instead of in any respect discreditable to them. Such method of liquidation avoided both loss and delay on the part of the depositors of the bank in receiving their money. It avoided loss to the stockholders of the bank, which would have necessarily resulted had the directors failed to act and permitted an involuntary liquidation of the bank to terminate the run.

Based upon the charges contained in their bills the appellants asked for an injunction against the bank proceeding with the collection of the indebtedness of the appellants to it. They asked for an accounting with respect to all financial transactions of the bank (presumably from the time of its organization to and through its liquidation) to the end that there might be reimbursement to the appellants for the losses sustained by them through the impairment of value of their stock arising from the liquidation of the bank.

The relief sought was denied by the learned trial judge through the application of those legal principles which have been so frequently stated by the courts as to have been crystallized into clear and definite rules of law. These principles were applied by the trial judge during the three weeks trial, which, at the behest of counsel for appellants, went far afield. They were succinctly stated in the opinion of the trial judge, which preceded the decrees dismissing the bills for lack of equity. They will be discussed hereinafter in connection with such answer to the specifications of error as it is deemed necessary to make.

Except for the strictly legal question presented by the first specification of error, based upon the refusal of the court to entertain jurisdiction of the cause as to the director Chauncey McCormick, all of the specifications of error, two to seven, are general in terms and present but the single question of alleged error resulting from the dismissal of the bills. To an understanding of the case there is essential a knowledge of the history of the institution, its spectacular rise, its somewhat troubled existence during the last years of its life, and its more spectacular fall. This history can be gleaned from the statement of evidence, and in succinct form we shall attempt to present it.

The bank was organized in 1912 with an original capital of $500,000.00 and a surplus of $100,000.00, which capital and surplus, by successive increases, the last of which took place in July, 1922, became capital of $2,000,000.00 and surplus of $400,000.00. (R. 10, 71.)

With its original capital of $500,000.00 and surplus of $100,000.00 the bank began business on January 2, 1913. (R. 10.) The first president of the bank was Henry L. Pittock, who during his lifetime was one of the largest stockholders and whose estate after his death continued to be one of its largest stockholders. (R. 428.) Mr. Pittock died in 1919. After his death, Emory Olmstead became the president of the bank and continued as its active executive head (R. 492) until his resignation on the 28th day of February, 1927, when he was succeeded in office by O. L. Price. (R. 4.)

The institution was conspicuously successful during the early years of its life. There were two years during its history when it grew more rapidly than any bank in the United States. In 1915 it had deposits of approximately $5,000,000.00. Within two years thereafter these deposits had practically doubled, and by 1920 its deposits had increased to $28,000,000.00. (R. 710.) Its earnings were large. It was paying dividends which it continued to pay until 1920, but it was this very period of extremely rapid growth which was responsible for loans being made out of which there later grew enormous losses. Indeed losses suffered by the Northwestern, growing out of loans made *subsequent* to 1920, were negligible, amounting to not more than $100,000.00. (R. 599.)

In 1920 the deflation period began. This was general throughout the United States, and its effect upon the national banks of the United States is set forth in the annual report of the Comptroller for the year 1921, from which we quote as follows:

"The year has been one of the most trying through which banking institutions have passed in a long period. Following an experience of inflation which, considering its world-wide extent, was perhaps without parallel, the banks in the past year have been under the necessity of facing the reaction in the form of progressive deflation. * * *

It was inevitable that the period of deflation which followed the war's expansion of credits should be intense, and quite in proportion to the extent of the inflation. * * *

The deflation in prices in the last year and a half has tested the solvency of every bank in the land, presenting acute conditions which required the most skillful handling."

But the situation which existed generally in Oregon and throughout the United States was peculiarly acute in the Northwestern National Bank. As its increase in deposits had been more than normally rapid so did its recession in deposits become more than normally heavy. From the peak of deposits in 1920 of $28,000,000.00 within two years the deposits dropped to $16,000,000.00. (R. 710.) In 1920 the loans of the bank were $19,-000.000. To pay the depositors who withdrew $12,-000,000.00 during the two year period following 1920, loans had to be collected where it was possible to effect speedy collection, with the result that the finest and best notes that were in the note pouch of the bank were called and the slow loans which could not be speedily collected accumulated. (R. 711.) The bank found itself with a frozen loan account of the proportion that

might be expected in a bank with $28,000,000.00 in deposits, but with deposits of $16,000,000.00 only. Its earning capacity was limited by the amount of its deposits, and upon the $16,000,000.00 of deposits it was required to earn enough to absorb the losses that had been developed under unusual conditions in a bank almost twice as large. The resulting condition was a very serious one. (R. 711.)

This situation the directors met to the extent of their ability. They realized the situation to the fullest. It was repeatedly and forcibly called to their attention by the various letters of the Comptroller which followed the periodic examinations of the bank. The directors were regular in their attendance at the directors' meetings. The members of the Executive Committee were indefatigable in their efforts to meet the situation, and find a solution of the serious condition which confronted them, for the existence of which they were not responsible. (R. 494, 669, 711.) We find the Board meeting regularly and giving consideration to all loans that were giving trouble. We find the Executive Committee paying extremely close attention to these matters, meeting regularly every Tuesday, considering old loans as well as new loans and renewals, and devoting a great deal of time in their efforts to work out the problems of the bank not only at meetings but by dropping into the bank every day to see what could be done. (R. 669.) If mistakes were made, and they were not many, they were mistakes of judgment and not those of inattention. These directors make no claims to omniscience nor infallibility. It is not believed that they will be held re-

sponsible for falling below that degree of success which omniscience alone could produce, or be required to become involuntary guarantors of the solvency of all debtors of the bank.

Although the amount of loss incurred by the bank on loans made subsequent to the deflation period was small (R. 669) and although its earnings were substantial, running from $150,000.00 to $200,000.00 a year from 1920 on (R. 668) and although none of these earnings was paid in dividends after 1920 (R. 668) but all were used in writing off the paper which the bank examiner from time to time declined to permit the bank to continue to carry longer among its assets, the losses continued to accumulate. They accumulated to the extent that the earnings were inadequate in a short period to create the funds necessary to remove the bad, slow or doubtful paper from the bank as speedily as it was desired to remove it and the directors were thereupon confronted with the problem of devising some means by which these assets of dubious value could be removed from the bank and the resumption of dividends made possible.

The Treasury Department, through the reports of its examiners, was in close touch with the situation and cognizant of the efforts of the officers and directors to improve the situation. The examiner reported after his examination of July 11, 1924, "that both officers and directors appear to be doing everything possible to remedy conditions" (R. 360) and again after the examination of February 24, 1925, "that the management is working earnestly to improve the bank's condition"

(R. 373). But it was realized by all that something of a drastic and constructive nature must be done.

In 1925 the suggestion was made that a corporation be organized among the shareholders of the bank for the purpose of purchasing as much as possible of its non-income producing assets. (R. 381, 382.) This recommendation, which apparently originated with the National Bank Examiners, was approved by the Examining Committee and called to the consideration of the Board in its report of December 23, 1925. (R. 387.) Subsequent to an examination of the bank, conducted by Bank Examiner Wylde in March, 1926, the recommendation went further and the Department then urged that a company be organized with sufficient paid-in capital to take out of the bank all of the real estate then owned or then in contemplation of acquisition, and in addition all assets of questionable character. (R. 394.) This plan was discussed by the directors during March and April of 1926 and the conclusion reached that such company should be organized with sufficient capital to enable it to acquire from the bank all of its assets which had been criticised by the Department so that future criticisms could be avoided and the payment of dividends resumed. Indeed the plan had been fully developed and approved by the Board prior to the receipt from the Department of its letter of April 26, 1926, commenting upon the Wylde examination of April 6, 1926. (R. 671.) A committee consisting of Mr. Metschan, who was a member of the Examining Committee, Mr. Stewart, who was a vice-president of the bank actively concerned in the handling of its slow

and frozen assets (R. 707) and Mr. Price, who was a vice-president and chairman of the Board of Directors (R. 668) went to Washington in June, 1926, and discussed the matter with the Comptroller, who gave his tentative approval to the plan and stated that he would give his final consent thereto or state any objection thereto he might have after the next regular examination which was scheduled to take place in the fall of 1926. (R. 672.)

The plan as put before the Comptroller was to effect the organization of a corporation with paid-in capital of $750,000.00, which was to be procured by each stockholder of the bank subscribing $37.50 to the capital of the corporation proposed to be organized for each share of stock in the bank. With this capital it was proposed that the corporation purchase frozen or slow assets in the amount of $1,500,000.00, paying to the bank therefor $750,000,000 in cash and giving to the bank its bonds in the amount of $750,000.00, the payment of which bonds was to be secured by lien upon the entire million and a half of assets so to be acquired from the bank. (R. 673.) At this same conference consideration was also given to a suggestion of the Department that there be effected a change in the management of the bank (R. 393) but the conclusion was reached at this conference in Washington that it was not advisable to effect any change in the management of the bank, through the resignation of its president, Mr. Olmstead, until after the proposed liquidating company had been organized and the transfer of assets effected. (R. 673.) The Comptroller felt that Mr. Olmstead was the one

best equipped to explain the necessity for the organization of the liquidating company to the stockholders of the bank and induce them to join in the organization of the company. (R. 673.)

It was the understanding with the Comptroller that adoption of the final plan for organization of the liquidating company should be deferred until after the examination in the fall of 1926, but during the interim the directors and the officers of the bank were active in interviewing the stockholders of the bank and in enlisting their support of the proposed plan. (R. 673.)

Subsequent to the examination of September 21, 1926, which showed non-bankable assets of $2,766,396.90, of which $490,468.74 were listed as doubtful, and $809,747.25 were listed as prospective losses (R. 401), Mr. T. E. Harris, the Chief National Bank Examiner who made the examination, recommended that new capital in the minimum amount of one million dollars should be provided for the purpose of eliminating sub-standard assets from the bank. This recommendation was approved by the Department in it's letter of December 2, 1926 (R. 409) and the expectation was there expressed that action would be taken to comply with the examiner's recommendations. A personal conference was held in San Francisco in December of 1926 between the chairman of the Board and vice-president Stewart and the Comptroller of the Currency and Chief Examiner Harris, who had made the examination of September, 1926. (R. 673.) At this conference the whole situation was reviewed, the plan for a liquidating company was approved by the Comptroller, and Mr.

Price was advised that when it had been carried into effect the bank would be permitted to resume the payment of dividends. (R. 674.)

It cannot be doubted that had this plan been carried into effect the troubled period of the bank's existence would thereupon have come to an end and the bank would still be in business as a strong and honored financial institution in the City of Portland. Why this plan was not carried into effect and why the bank, which in December, 1926, was expected to emerge soon from its troubles, on March 29, 1927, forever closed its doors, brings us to the final chapter in the history of the unfortunate institution.

After the return of Messrs. Price and Stewart from San Francisco about Christmas of 1926, the officers and directors of the bank were very active in their attempts to induce all of the stockholders of the bank to make subscriptions to the stock of the liquidating company. The principal difficulty encountered was in procuring the required payment from J. E. Wheeler, who held a large block of the stock of the bank (R. 674) amounting to 4700 shares. (R. 428.) Mr. Olmstead had in immediate charge the task of procuring from Mr. Wheeler the necessary funds and from time to time reported to the Board with respect to the progress that Mr. Wheeler was supposed to be making in liquidating some of his assets which would enable him to pay the amount of his desired subscription. (R. 674.) Nor was it until the discovery of the so-called "float" in February, 1927, by which Wheeler abstracted from the bank $800,000.00 of its funds, that the Board knew

that the consummation of this plan, as agreed upon with the Comptroller, could not be effected, and that some other action would have to be taken if the bank were to be saved.

It appears from the testimony of some of the minor officers of the bank that beginning in July or August of 1926, McCormick Lumber Company (a J. E. Wheeler company) began the practice of making deposits of checks and drafts drawn on the Brookville Title and Trust Company, Forrest County National Bank and Titusville Trust Company for which immediate credit was given McCormick Lumber Company, but which checks and drafts were frequently dishonored by the banks upon which they were drawn. When dishonored, these checks were held in an account of the bank known as "cash items" until they were removed therefrom upon other checks or drafts being substituted therefor. All such checks exceeding $1,000.00 in amount upon his orders were referred to and O.K'd for immediate credit by Olmstead, the president of the bank (R. 594), who was fully informed about and whose actions made possible these fraudulent transactions. (R. 594.) But it does not appear that any of the defendants in this case, other than Olmstead himself, knew of the existence of this practice until some time between the 7th and 8th of February, and the 15th of February, 1927. The situation was not discovered by the Examining Committee when it made its examination beginning November 19, 1926, nor was it discovered by Chief National Bank Examiner Harris when he made his examination which was completed on

October 26, 1926. During the period from May 6, 1926, to March 1, 1927, the account "cash items" varied from nothing to a maximum of $823,877.45 on February 28, 1927 (R. 579, 580, 581), which date was subsequent to the discovery of the "float," after which the practice was immediately stopped by mandate of the Board of Directors and the dishonored items permitted to accumulate. (R. 655.) The "cash items" were nominal and proper in amount on the dates on which Examiner Harris and the Examining Committee made their respective examinations in the fall of 1926.

The existence of the "float" was discovered by vice-president Jones some time in February, 1927, who immediately informed vice-president Skinner. (R. 559.) Mr. Skinner places this date in the first week of February. (R. 735.) Mr. Skinner immediately revealed the situation to vice-president Stewart, who procured a list of the dishonored checks in the cash items (R. 729) and together Messrs. Skinner and Stewart transmitted the information to Mr. Price, the chairman of the Board. Mr. Price, who up to that time had had entire confidence in Mr. Olmstead, questioned him with respect to the situation the following morning, and then forced from him the truth. (R. 679.) On the same day (Wednesday) Mr. Price called a meeting of the Board of Directors, and this meeting was held on the following Friday, on which day Wheeler returned from San Francisco.

When confronted with the situation by the Board, Wheeler confessed his inability to provide the bank with funds to discharge the worthless paper with which he

had flooded it. (R. 681.) The directors were almost constantly in session, with innumerable meetings night and day. (R. 726.) The plan to organize a liquidating company with a cash capital of $750,000.00, upon which the directors had been working, had to be abandoned because there was now that unexpected and presumably complete loss of an additional $800,000.00. To raise this sum, with Wheeler at the end of his rope, seemed to be an impossibility. (R. 683.)

Then it was that attempts were made to sell the bank. Separate negotiations were carried on with the United States National Bank and with the First National Bank, but the negotiations with the United States National Bank were not pressed because the negotiations with the First National Bank had gone forward faster, and the negotiations with the First National Bank were finally dropped because it declined to purchase unless, in addition to the present assets of the bank, a fund of $2,250,000.00 in cash were deposited to protect the First National Bank against the possibility of loss. (R. 684.)

The Board felt that if two million dollars had to be advanced in any event, it would be more to the advantage of the stockholders to render this sum available for the Northwestern National Bank, continuing the latter in business, and preserving the earning value of the institution. (R. 684.)

In an attempt to carry this plan into effect two plans were discussed, one the organization of a state bank with two million capital to purchase the business of the Northwestern, the other a one hundred per cent assess-

ment upon the stock of the Northwestern, with continuation of the latter under its existing charter. (R. 685.) At a meeting held late in February, 1927, the directors determined to secure subscriptions immediately for the two million required irrespective of which plan might be finally adopted, and almost the entire sum was actually subscribed that same night. Tentatively decision was reached that the plan of organizing a state bank was the better, but on more mature deliberation it was concluded that there were more elements of weakness than of strength in this plan and the final conclusion was arrived at that there should be imposed an assessment of one hundred per cent upon the stock of the existing bank, and that that bank should carry on. (R. 687.)

The local bank examiner was advised of the decision. The money was subscribed. The Board was convened. Olmstead presented his resignation and Price was elected president.

In order to effect an involuntary assessment of one hundred per cent upon the stock of the bank, it was necessary that, as a result of an examination of the bank, the determination be reached by the Comptroller that the assets of the bank were impaired to the extent of one hundred per cent of its capital. Examiner Crowley and Chief Examiner Harris, who made the examination, found it difficult to convince themselves that this impairment actually existed (R. 687), but nevertheless and to make an involuntary assessment possible, upon completion of the examination on March 5, 1927, Chief Examiner Harris estimated the losses of the bank

at $2,446,769.65. This was a sum slightly in excess of the entire capital, surplus and undivided profits of the bank. (R. 413.) The directors thereupon requested the Comptroller to issue a formal notice of impairment of capital so that they might proceed with the collection of an assessment of one hundred per cent, payment of which assessment was guaranteed by certain of the responsible shareholders of the bank. (R. 414.)

In the meantime the Board appreciated that the resignation of Mr. Olmstead would occasion comment and cause some withdrawals, and every effort was made to get the bank into the best possible condition to meet any adverse results that might follow the reorganization of the bank. (R. 688.) The directors feared the effects of rumor and felt that were publicity attached to the "float" dire results might follow. This was true even though arrangements had already been effected to replace the lost capital. (R. 721.) For this reason, and because of the known responsibility of the Pittock Estate, announcement of the change of management was made through the Morning Oregonian on the 2nd of March, 1927, in the form in which it appears in the bills of complaint. (R. 24.)

But in spite of all of the efforts of the directors, rumors affecting the condition of the bank became current. These rumors resulted in a decrease in deposits and excess of withdrawals. (R. 688.) There was the specific rumor of a defalcation in the bank, and efforts were made to explain the true situation to the people who had heard about it. (R. 688.) Indeed, there was no condition sufficient to cause any alarm among the

executives of the bank until four or five days before it closed (R. 688). On Friday, the situation became acute. The city was honeycombed with telephone calls about the condition of the bank. (R. 689.)

Mr. Price was in California engaged in efforts to increase the resources of the bank by collection of a substantial amount owing it by Portland Dollar Lumber Company and by procuring increases of the deposits of the Southern Pacific Company and the Standard Oil Company. (R. 689.) He was advised of the situation by long distance telephone on Friday and on Saturday left for Portland, where he arrived Monday morning. On Monday a crowd of depositors assembled at the bank and still remained when the bank finally closed its windows at six o'clock in the evening. The final run was under way.

The Portland Clearing House Association was urged to stand behind the bank but it declined to do so. There was then done the only thing which could have been done to make possible the meeting of the demands of depositors for their money, namely, the transfer of the assets of the bank to the First National Bank and United States National Bank under an assumption by the latter of the deposit liability of the Northwestern National Bank.

The terms of this agreement were onerous. (R. 425.) The agreement itself was made possible only by the gentlemen who are in this court as defendants pledging their personal fortunes to the extent of two million dollars and subordinating their claims to this extent to the claims of all others, while at the same time their

stockholders liability remained unaffected. It is to their lasting credit that they acted as they did. Liquidation of the bank thus accomplished doubtless prevented the suspension of many of the correspondent country banks of the Northwestern National scattered through Washington, Oregon and Idaho. (R. 726.) It made possible a liquidation without sacrifice and it prevented the necessity of an assessment upon the stockholders which, in the case of liquidation by a receiver, would have been inevitable. (R. 727.)

As soon as it became possible to do so the entire matter was submitted to the stockholders, and the action of the directors was approved by the affirmative vote of 16,915 shares out of a total of 16,955 shares represented at the meeting. (R. 435, 439.) Nor has there been any attack upon any of the directors except by these appellants, each of whom it is to be remembered, is seeking to avoid payment of his indebtedness to the bank as part of the relief sought for by him in his suit. (R. 28, 191.)

The history ends. So far as these defendants are concerned, except the defendant Olmstead, for whom we do not appear, it is a story of honor and not dishonor. In consideration of the more detailed argument which follows it is believed that this court will find, as did the lower court, that "these gentlemen were diligent in the administration of the affairs of this institution, exercised their best judgment after inquiring into and considering all the facts as far as they could. The Executive Committee consisted of seven members. It met once a week and passed on loans and lines of credit,

considered the bank policy, discussed with the executive officers the condition of its several obligations. The Examining Committee made regular examinations twice a year. The Board of Directors held full meetings of the Board once each month when these matters were reviewed and discussed, and plans developed concerning administration, and it seems to me, under all the circumstances of this case, it cannot be said that these directors were negligent to such an extent, if at all, as would justify a court in imposing any liability upon them. They may have erred in judgment but if so they are not responsible for that, and I am not prepared to say, on this testimony, that there was any error in judgment in the various transactions had by the Board. We must judge their acts by the conditions as they existed at the time the action was taken and not by subsequent developments, and therefore I conclude that the bills in each of these cases must be dismissed, and it is so ordered."

BRIEF OF THE ARGUMENT

1. Directors are not insurers of the fidelity of the agents whom they have appointed and who are not their agents but the agents of the corporation.

Briggs v. Spaulding, 141 U. S. 132, 35 L. Ed. 662.
Rankin v. Cooper, 149 Fed. 1010, 1013.
Devlin v. Moore, 64 Ore. 433, 462.

2. Directors are not responsible for loss resulting from the wrongful acts or omissions of other directors or agents of the corporation unless the loss is the consequence of their own neglect of duty either for failure to supervise the business with attention or neglecting to use proper care in the appointment of agents.

Briggs v. Spaulding, supra.

3. Bank directors are not trustees in any technical sense. The relation between them and the corporation is rather that of principal and agent.

Briggs v. Spaulding, supra.

4. The directors of banks from the nature of their undertaking are called upon to exercise nothing more than ordinary care and attention. It is not contemplated that they should devote their whole time and attention to the institution to which they are appointed and guard it from injury by constant supervision.

Briggs v. Spaulding, supra.
Rankin v. Cooper, supra.
Swentzel v. Penn. Bank, 147 Pa. 140, 15 L. R. A. 305.

5. A director cannot be held liable for being defrauded; to do so would make his position intolerable.

Briggs v. Spaulding, supra.
Land Credit Company of Ireland v. Fermoy, L. R. 5 Ch. 763, 770.
Swentzel v. Penn. Bank, 147 Pa. 140, 15 L. R. A. 305.

6. Directors are not liable, in the absence of positive misfeasance, for passive negligence; it must appear that the losses for which they are required to respond were the natural and necessary consequence of omission on their part.

Briggs v. Spaulding, supra.

7. It is not a violation of law to permit the executive officer of a bank to conduct its business provided that reasonable oversight is kept by the directors.

Briggs v. Spaulding, supra.
Rankin v. Cooper, supra.

8. There is no law requiring bank directors to adopt a system of espionage in relation to the executive officers, or to set a watch upon all their actions. They are supposed to be honest until the contrary appears.

Briggs v. Spaulding, supra.
Rankin v. Cooper, supra.
Bates v. Dresser, 251 U. S. 524. 64 L. Ed. 388.
Bates v. Dresser, 250 Fed. 525.

9. Knowledge of what the books and records would have shown is not to be imputed to the directors. If such was the law the position of a director of a large corporation would be one of constant peril.

Briggs v. Spaulding, supra.
Murray v. Third National Bank, 234 Fed. 481, 490.

10. A director is not liable for false statements made in a report prescribed by the Federal statutes unless he had actual knowledge of its falsity. Mere negligence in participating in such a report is not actionable either because of a directors' common law liability or that fixed by statute.

Gamble v. Brown, 29 (2d) Fed. 366, 370.
Yates v. Jones National Bank, 206 U. S. 158, 551 L. Ed. 1002.

11. A director is not liable for alleged false statements except to those who have acted upon such reports to their damage by purchase of the bank's stock or by depositing funds with the bank.

Chesbrough v. Woodworth, 244 U. S. 72, 61 L. Ed. 1000.

12. Inasmuch as the damages are personal to the party so deceived he must sue in his own right and not for the association or other stockholders or depositors and the action is one at law.

Chesbrough v. Woodworth, supra.
Benton v. Deininger, 21 Fed. (2d) 657.

13. Where such an action is brought the provisions of the Federal statute are exclusive and preclude the common law liability for fraud and deceit and must be measured by the words of the statute.

Chesbrough v. Woodworth, supra.
Curtis v. Metcalf, 265 Fed. 293, 296.

14. No one can contend that a director must look into details of management or keep closely in touch with routine matters or know intimately to whom credits are given, but he is responsible for the exercise of supervisory control and must be held to know something of the more important concerns of the association.

McCormick v. King, 241 Fed. 737 (9th Circuit).
First National Bank v. Noyes, 257 Fed. 591, 600.

15. The limitation of U. S. R. S. 5200 upon the total liabilities of any single borrower to a national bank will not be construed as including his liability as surety or indorser for money borrowed by another.

Corsicana National Bank v. Johnson, 251 U. S. 68, 64 L. Ed. 141.
Gamble v. Brown, 29 (2d) Fed. 366, 375.

16. Where a bill alleges aggregate loans to an individual in excess of those permitted under Revised Statute 5200, it should clearly show whether the defendants are to be charged with the whole loan or only with the excess, for the liability under Section 5239 applies only to the particular loans which exceeded the statutory limit.

Curtis v. Metcalf, supra.
Witters v. Sowles, 43 Fed. 405.
Rankin v. Cooper, 149 Fed. 1010, 1017.
Stephens v. Overstolz, 43 Fed. 771, 775.

17. It is insufficient to charge in general terms that a large part or the whole of a loss from a loan might have been saved by action with reasonable promptness.

Curtis v. Metcalf, 265 Fed. 293, 296.

18. Where defendant directors are charged with negligence, the bill must specify the action or inaction relied upon, as the defendants are entitled to know the kind of alleged negligence upon which the complainant will rely.

Curtis v. Metcalf, supra.

19. Defendants' failure to move against the bill does not relieve the complainant of the duty of proving those facts necessary to constitute a cause of suit against the defendants. An uncertain and insufficient bill may be aided by definite and sufficient proof but failure on the part of the defendants to move against an insufficient or uncertain bill does not entitle the complainant to relief when his proof is as insufficient or uncertain as his bill.

Curtis v. Metcalf, supra.

20. Directors are not liable for mistakes in judgment.

Fidelty Loan & Savings Co., 142 Va. 43, 128 S. E. 615, 45 A. L. R. 664.

Braswell v. Pamlico Ins. & Bkg. Co., 59 N. C. 628, 42 L. R. N. S. 101.

Dunn v. Kyle, 14 Bush. 134.

Sperings' Appeal, 71 Pa. 11.

Muller v. Planters Bk. and Trust Co., 169 Ark. 480, 275 S. W. 750.

Am. Sav. Bank & Trust Co. v. Earles, 113 Wash. 629, 194 Pac. 555.

In discussing the law applicable to this case we deem it wise to attempt to clarify the atmosphere of the fog of language by narrowing the issues and endeavoring to show what is actually involved in these appeals.

1. It is not claimed that these defendants were in any sense guilty of fraud or deceit or of any kind of speculation or conversion of the assets of their bank to their own benefit, or of any misuse of their powers to their individual advantage.

2. It is not claimed that the actions of any of the directors other than Olmstead were induced by any motive other than that of benefiting the bank and safeguarding its stockholders and depositors.

3. It is not claimed that the defendants, when called upon to make decisions, did not honestly exercise their own best judgment and discretion.

4. It is not claimed that the defendants did not attend all meetings of the board or give such time and attention to the bank's affairs as is ordinarily required of bank directors.

5. With the exception of directors Skinner, Stewart and Price, it is not claimed that any of the defendants had the slightest knowledge of the criminal actions of Olmstead and Wheeler with regard to the "float."

6. As to Skinner and Stewart, the proof is overwhelming that they did not have such knowledge except that on possibly two or three occasions attention was called to the fact that certain foreign items which the McCormick Lumber Company had deposited had been returned dishonored and that upon making inquiry of the president of the bank, who had charge of that account, were assured by him that the checks had been taken care of.

7. As to Price, the evidence is overwhelming that he never had knowledge of the float or of anything which would arouse the suspicion of an ordinarily prudent man.

8. No excess loans were made at any time unless it be claimed that the Wheeler float was such. No evidence was offered that any of the loans specified in the bill of complaint were at the time they were made other than legitimate banking loans to persons or concerns who were at the time entitled to the credit advanced them.

9. No evidence was offered that the directors and executive officers of the bank did not exercise every possible effort to realize upon frozen and unsatisfactory loans and to reestablish the bank upon a dividend-paying basis.

10. The Wheeler float was cleverly concealed at the time of the examinations made by Harris, the Federal Bank Examiner and the examining committee by removing dishonored checks from "cash items" where they would be readily discovered, by substituting new checks, (O. K.'d by Olmstead and sent forward for collection to the eastern banks upon which they were drawn), and thus concealed in the account "items in transit."

11. The Board of Directors as and when losses were ascertained, and at all times when they received either direction or suggestion from the bank examiners or the comptroller, charged such losses from the assets of the bank and never included them in their reports as a part of the bank's assets.

12. Neither of the complainants either purchased their stock or deposited money in the bank relying upon any alleged false or misleading statements of assets or liabilities.

In order to hold these defendants liable in this case an entirely new and unheard of rule must be established, which would be abhorrent to every principle of equity and law, and which would cast such an onerous and intolerable burden upon able conscientious and sub-

stantial members of the community that no man could afford to accept a directorship in any railroad, bank or corporation of large business affairs.

Stripped of its verbiage, complainants say to the defendants:

(a) It is immaterial that you were honest;

(b) It is immaterial that you did not use your office for wrongful ends;

(c) It is immaterial that you used your best judgment;

(d) It is immaterial that you exercised at least ordinary care;

(e) It is immaterial that the loans which you made and approved were at the time of their making legitimate, proper, and good banking;

(f) It is immaterial that the persons and firms to whom you loaned money were entitled to the credit and were solvent;

(g) It is immaterial that when the general deflation came that you took every action which your honest judgment deemed necessary to safeguard the bank and realize upon its loans.

(h) It is immaterial that you had made plans and pledged the necessary funds to remove the frozen assets and restore the bank to a liquid condition;

(i) It is immaterial that you attended all of the prescribed meetings of the Board of Directors, and in addition thereto conferred informally with each other

and with the executive officers with regard to the affairs of the bank, and adopted such measures as your best judgment dictated;

(j) It is immaterial that Wheeler and Olmstead without your knowledge criminally abstracted $800,000 of the bank's assets;

(k) It is immaterial that in order to save the depositors and the stockholders you pledged your individual fortunes to the extent of $2,000,000 in addition to your statutory stockholders' liability,—

The fact remains that the bank suffered severe losses by the criminal acts of Olmstead and Wheeler, and by reason of failure to realize upon loanes which were legitimate and proper in their inception, but which, by reason of the period of deflation, became frozen or unsatisfactory as bank assets. Therefore it is incumbent upon you, out of your personal fortunes to make good every item which was ever in the bank from its inception and upon which one hundred cents on the dollar was not realized.

The trial court made a pertinent inquiry of complainants' counsel at the time of argument, which he did not then answer and which cannot be answered. We quote substantially: "What should the directors have done with the frozen loans in the bank?" "What it their duty to remove these loans by using their own funds?" Complainants' counsel had no concrete or definite suggestion as to the first of these inquiries and frankly stated that he did not consider it the duty of the directors to individually remove the frozen loans.

The federal courts have had occasion in many cases to consider and determine the duties and obligations assumed by directors of national banks. These duties and obligations have been concisely capitulated by the learned judge in

Rankin v. Cooper, 149 Fed. 1010

as follows:

"1. Directors are charged with the duty of reasonable supervision over the affairs of the bank. It is their duty to use ordinary diligence in ascertaining the condition of its business, and to exercise reasonable control and supervision over its affairs. 2. They are not insurers or guarantors of the fidelity and proper conduct of the executive officers of the bank, and they are not responsible for losses resulting from their wrongful acts or omissions, provided they have exercised ordinary care in the discharge of their own duties as directors. 3. Ordinary care, in this matter, as in other departments of the law, means that degree of care which ordinarily prudent and diligent men would exercise under similar circumstances. 4. The degree of care required further depends upon the subject to which it is to be applied, and each case must be determined in view of all the circumstances. 5. If nothing has come to the knowledge to awaken suspicion that something is going wrong, ordinary attention to the affairs of the institution is sufficient. If, upon the other hand, directors know, or by the exercise of ordinary care should have known, any facts which would awaken suspicion and put a prudent

man on his guard, then a degree of care commensurate with the evil to be avoided is required, and a want of that care makes them responsible. Directors cannot, in justice to those who deal with the bank, shut their eyes to what is going on around them. 6. Directors are not expected to watch the routine of every day's business, but they ought to have a general knowledge of the manner in which the bank's business is conducted, and upon what securities its larger lines of credit are given, and generally to know of and give direction to the important and general affairs of the bank. 7. It is incumbent upon bank directors, in the exercise of ordinary prudence, and as a part of their duty of general supervision, to cause an examination of the condition and resources of the bank to be made with reasonable frequency."

Testing the conduct of the defendants in this case by the rules there laid down, we find that they have fully met the standards set forth. The directors exercised reasonable supervision over the affairs of the bank. They met frequently, they discussed the loans, discounts, deposits, slow loans, and general affairs and bank policies. In addition, they had an executive committee which met weekly and passed upon each loan made by the executive officers during the preceding week, and came to a determination upon applications for the larger loans, namely, those in excess of $25,000. In a bank of that size it was necessary to place larger lines of credit in the hands of different executive officers. The wisdom and the necessity of this course is apparent. No one man could keep in touch with the

business affairs of every customer of the bank using its credit. Certain lines of credit therefore were necessarily placed under the particular charge of the president, Emery Olmstead, others under the charge of vice-president Charles Stewart, others in charge of vice-president Skinner. Smaller loans were acted upon by assistant vice-president Jones. Except in those cases, therefore, where the directors had personal knowledge with regard to the customers' affairs, they relied to a large extent upon the detailed information transmitted to them by the executive officers, who appeared before them at their frequent meetings and discussed with them the policies of the bank, and the credits to be extended to its customers.

It would be as unfair and impracticable to charge the directors with negligence in not having an intimate personal knowledge of each loan made as it would be to require a director of the United States Steel Corporation or of a large railway corporation to have intimate knowledge of the details with regard to every transaction of the company which he represented. In these days of large business transactions, delegation of authority is essential, and the directors must from the very necessity of things rely to a large extent upon the technical or special knowledge of the executives whom they appoint to act for the corporation. See—

Briggs v. Spaulding, 141 U. S. 132, 35 L. Ed. 662.

Mason v. Moore, 4 L. R. A. (N. S.) 597; 73 Ohio State 275.

The fact that Wheeler, one of the bank's largest stockholders, with the active cooperation of Olmstead as president, succeeded in misappropriating practically $800,000 of the bank's funds by means of false credits obtained by the deposit of checks drawn on eastern banks and subsequently dishonored by them for lack of funds, does not render the directors liable, inasmuch as they are not insurers or guarantors of the fidelity and proper conduct of the executive officers of the bank.

We do not mean to say that where directors had actual knowledge of the fraud of a trusted employee, or where they had knowledge of acts sufficient to arouse their suspicion and to put them on guard, and then permitted the suspected employee to continue in his practices, they would not be liable. They had no reason to suspect Olmstead's honesty or trustworthiness. His wisdom in making loans had been questioned and the Board of Directors in 1924 had passed a formal resolution limiting his power and that of other executive officers in that regard; but that resolution was not based upon any suspicion of his probity. The evidence discloses that several of the junior officers of the bank were aware of the fact that the McCormick Lumber Company checks were being returned dishonored by the banks upon which they were drawn, but this fact was not drawn to the attention of any of these defendants with the exception that it is claimed that Bates, the cashier, sometime in July or August, 1926, informed director Skinner that some of the McCormick items were coming back. Skinner took the matter up with President Olmstead, who informed him that the matter

had been taken care of. There is nothing unusual or alarming about the fact that checks deposited by a customer are returned;—that is common to every bank every banking day, nor is it a matter of alarm that a customer may issue one or more checks which his bank is compelled to dishonor because of lack of funds. Those are matters of routine which are handled by the officer of the bank having charge of that account, and upon his assurance that the matter has been taken care of, in the absence of any other circumstances the affair would and should end.

Olmstead claims that sometime in July, 1926, he knew for the first time that McCormick checks in volume were coming back and that he informed the defendant Price of this fact. This Price specifically denies and the testimony thoroughly discredits Olmstead's story with regard to that. It is apparent that from the inception of the float in the spring of 1926, Olmstead had both knowledge of and was an active participant in the transaction, and it was only by his continued participation that it grew to such alarming proportions.

In view of the prompt action taken by Jones, Skinner, Stewart and Price when they first learned of the float in February, 1927; in view of the further fact that during those months Price was actively engaged in organizing a holding company to remove frozen assets from the bank, which involved stock subscriptions from all of the stockholders in the bank, including Wheeler (Record 645, 646); in view of the fact that the defendant directors were constantly urging Olmstead to further efforts in reducing Wheeler's indebt-

edness, it is beyond the realm of probability that Price, if informed in July of a float of $200,000, would have taken no action whatever and would have permitted it to continue until nearly $800,000 had been abstracted from the bank, and the investment of the Pittock Estate, of which Price was one of the trustees, so jeopardized.

Counsel does not point out in his brief, nor did he offer any evidence tending to show that any of the directors other than the defendant Olmstead, did not exercise both the care which ordinarily prudent and diligent men would have exercised under similar circumstances, or that degree of care which the nature of their duties required, and the circumstances of the case demanded. On page 78 of complainants' brief is found the following statement: "The gist of this whole matter is inattention to and mismanagement of the affairs of the bank." No attempt was made by the complainants to prove inattention or to prove mismanagement with regard to the loans made during the history of the bank. The complainants say (p. 99 of brief) that in addition to the Wheeler transactions the directors were guilty of inattention and mismanagement as follows:

"In not seeing what was open, visible and notorious to be seen in and about and upon the records of said bank." No further specification is made as to what they should have seen other than the Wheeler transaction, which will be more fully discussed hereafter.

Next, complainants say (p. 99): "In not acting upon what was or to be seen and thereby to be known in the records of said bank so that said bank might have

and obtain prompt and vigorous management, direction, supervision and activity in regard thereto." Again the specification is vague and neither brief nor evidence discloses what the directors should have seen or what their action should have been in the premises.

Next, negligence is specified, again quoting from p. 99, "In not forcing Wheeler's liquidation in the sale of his publishing business or other properties, and call his then loans that the burden of his indebtedness to the bank might be relieved." In that regard the record is plain that the matter of reducing Wheeler's personal indebtedness and that of the various corporations in which he was interested, received the continuous consideration of the members of the board; that the president of the bank had been directed to use every effort to procure liquidation of these loans; that he was actively engaged in assisting Wheeler to dispose of his timber; that director Collins had from time to time consulted with Wheeler and urged him to liquidate and sell even at a sacrifice. In fact it is only fair to Mr. Olmstead to state that his actions in participating in the float were in all probability induced by a desire to keep Wheeler's head above water until such time as a sale of his redwood timber, which was then in process of negotiation, could be consummated.

With regard to the sale of the TELEGRAM there was a division of opinion as to the advisability of attempting to compel him to make a sale of that property rather than of some of his other property, especially in view of the fact that if a sale should be made it was doubtful if the bank would receive any substantial bene-

fit. Upon those questions different minds had different opinions but the individual directors exercised their own honest judgment. Nor is it true that the directors had any power to compel Wheeler to sell, or that Wheeler was willing to sell. If any of them erred it was an error of judgment for which there is and should be no liability.

It is said that:

> "Mere poor judgment in making loans is not sufficient to form a basis for liabilities of directors for, when they are selected by the stockholders the latter assume the risk of losses occurring on account of defects in judgment and the directors by accepting office merely assume the obligation to manage the affairs of the institution with diligence and good faith."

Muller v Planters Bank and Trust Company, 169 Ark. 480; 275 S. W. 750.

It is next specified that the directors were guilty of mismanagement in "waiting and delaying action on matters of importance until an emergency was thereby created (a) in conditioning the assets of the bank; (b) by increasing the Wheeler indebtedness and financial embarassment; and (c) for failing to deal for the sale of the paper on frequent proper occasions of the Telegram Publishing Company, and until that company went broke."

We answer them, using the same classification: (a) The evidence showed that the directors used every endeavor to re-condition the assets of the bank; that the

larger stockholders had formed a plan not only to subscribe for their proportion of the stock in the new corporation, which would take out the frozen assets, but to advance the necessary funds for the proportionate share of incapable or unwilling stockholders. (b) The directors of the bank did not increase Wheeler's indebtedness and financial embarassment, except in one instance, where a loan was made in order to get good collateral. The wisdom of this transaction was demonstrated, as the collateral not only liquidated the new loan but greatly assisted in liquidating the previous ones. However, Wheeler and Olmstead, by means of the float, and without the knowledge or consent of the other directors, succeeded in increasing Wheeler's indebtedness some $800,000, and thereby causing the bank "financial embarassment." (c) The evidence shows that the only time that Wheeler had an actual opportunity of selling the TELEGRAM, a time when the directors were both willing and insistent that he should sell it, Wheeler refused to consummate the deal.

The next specification of mismanagement is "In dallying over a period of years with the comptroller, and failing with promptitude to clean up the matter of financial entanglements which finally overtook them and which were called to their attention by the Comptroller." We are inclined to view with impatience such vague charges, especially in view of the fact that there was no proof to substantiate them, and no suggestion made by the complainants or their counsel as to what should have been done or could have been done by the directors, which they failed to do. Surely one who is

charged with negligence is entitled to know of what his negligence consists and what he should have done that he did not do or what he did that he should not have done. Neither the complaint, nor the evidence nor argument supplies any of these elements.

The next two specifications of mismanagement consist of electing Price to the position of president of the bank. Again complainants use language which we must confess conveys no meaning to us. It is not alleged or proved that Price was inefficient, corrupt or incapable. If the complainants mean by this specification that the fact that he was manager of the Oregonian, or a trustee of the Pittock Estate rendered it improper for him to become president of the bank, we can only say that there is nothing in the record to so indicate. The interests of the OREGONIAN and the Pittock Estate were not antagonistic to the interests of the bank, and certainly none of his actions, either before or after his election, would warrant the presumption of either inefficiency or dishonesty. He evinced steadiness and courage when facing a condition which would try the fortitude of men of higher courage. Without hesitation he pledged his own personal fortune to save the depositors and stockholders of the bank. His actions in the crisis were such as to commend him to the good opinion of his community and to warrant the faith placed in him by Henry L. Pittock in making him one of the trustees of his estate.

Next, plaintiffs specify mismanagement on the part of the defendants "In failing to allay and remove internal dissension and sustain coordinate effort within

the bank by change of management." The evidence shows that losses from loans made subsequent to 1921 were entirely negligible. Nothing transpired from 1923 until February, 1927, to arouse any suspicions as to Olmstead's honesty. The question of change of management was discussed by Price, Metschan and Stewart with the comptroller in 1926 and the comptroller informed them that he thought it would be unwise to make any change in management until after the bank had availed itself of Olmstead's ability in persuading the bank's stockholders to subscribe to the holding corporation, which would remove the frozen assets. (Record, 645, 646.)

Next, it is specified "That the directors were negligent in bringing about an entire change of management in bank policy by the Pittock Estate and the induction of Price." What this change of policy was is not revealed by the evidence or suggested in the brief nor is there any foundation of fact that negotiations carried on by Price with the First and United States National Banks disclosed to the public any weakness in the Northwestern National Bank.

Next, "In knowingly creating and permitting an emergency to develop in the affairs of the bank through their own acts or acts which could have been prevented in the ordinary exercise of business judgment." It should be sufficient to say that the record shows that the directors did not create or permit an emergency to develop, either through their own acts or any act which by the exercise of ordinary business judgment, they

could have prevented. The emergency was created by the unknown acts of a trusted officer in conjunction with one of the largest stockholders of the bank, acts for which the directors were not responsible, of which they had no knowledge, and for which they had no reason for suspicion.

The complainants allege "Mismanagement in knowingly and willingly permitting non-included stockholders in the deal they made to become liable for a stockholder's statutory liability and liability by virtue of the contract to the First National and United States National Banks without first conducting a deliberative vote by the body of the stockholders." Wisdom after the event is available to the most stupid and the man on the sidelines after the play has been made always thinks he is able to point out its defects. However, we have never known swivel-chair strategists to become Napoleons, nor sideline experts to be either successful players or coaches. These directors were faced with a condition and not a theory. They were called upon to meet an emergency which was imperative. Their first duty was to persons who had deposited money in the bank, and to the correspondent country banks, a large part of whose current working capital was deposited with them. Had they not acted with promptness and courage, Portland and the communities in the Pacific Northwest would have suffered a financial satastrophe of tremendous proportions. To induce the First and United States National Banks to assume the deposit liability of the Northwestern, the directors entered into a joint and several guaranty of their personal fortunes

to the extent of $2,000,000. Their action received the support of 16,915 shares out of a total of 16,955 shares. By acting when and as they did the bank was not thrown into a receivership, the depositors received every dollar of their money and, notwithstanding the hurried estimates of uncollectible paper in the bank, the directors have not been called upon to make good their guaranty nor has it been necessary for the Comptroller of the Currency to make any assessment against the stockholders. If the bank's assets at the time of the transaction complained of were not sufficient to discharge the liability for deposits then the statutory liability existed even though no sale were made. If they were sufficient, then no such liability in fact existed. By acting as they did and when they did, as was said by Judge Bean, the following consequences were avoided:

> "The bank would in the nature of things have been compellel to have gone into involuntary liquidation through a receiver appointed by the Comptroller of the Currency, and while the evidence does not disclose particularly the condition of the bank at that time, in view of results that usually and ordinarily obtain in a receivership of that kind, it is not probable that the assets at a forced sale would have been sufficient to take care of its liabilities and therefore there would have been a stockholders' liability remaining against these persons complainants, while now, under the present arrangement, and the way it is working out, as the evidence indicates, these liabilities will probably be paid and discharged without calling on the stockholders and probably with sufficient to re-

turn to the directors the amount of money they deposited as security."

The next item of mismanagement alleged is "By making and renewing excessive loans and knowingly and willingly permitting them to be so made against sound business policy and against the law." The bank made no excessive loans, and with the exception of the Wheeler float the indebtedness complained of was contracted prior to 1923, and was legitimate, proper, and presumably safe at the time the credit was extended. All of the loans were made before directors Collins and Spaulding were elected to office and no evidence was offered that at the time of their inception they were improvident, excessive or improper, and as the learned trial judge said: "It is therefore fair to assume in the absence of evidence, that they were prudently made at the time that they were contracted."

Complainants next allege that incorrect reports were made to the Comptroller. We assume that counsel thereby adverts to the difference between the amount of the capital, surplus and undivided profits shown in the report to the Comptroller and the same items as appeared in the condensed published statements. We are rather surprised that counsel should urge this point, inasmuch as it is perfectly clear from the statements themselves that in the itemized statement to the Comptroller the item "Reserve for taxes + accrued interest" was not included in capital, surplus, and undivided profits but appeared under a separate heading of its own, while in the condensed published statement it was included, and properly included, under those items. Counsel's attention

was called to this matter at the time the evidence was offered and in the course of his argument, and the matter is so plain upon the face of the record that we are at a loss to understand why he should again fall into such an obvious error. On the other hand if the complainants by this specification are contending that the statements made by the bank to the Comptroller and published as required by law were incorrect as to the condition of the assets of the bank, it is only necessary to call the court's attention to the following facts:

This bank, as well as all other national banks, was carefully examined by a national bank examiner at least twice a year. The condition of its assets, the amount and extent of its losses, actual or probable, were, as the examining reports show, known to the Comptroller's office and were the subject of continued correspondence between the office of the Comptroller, either directly or through his representatives, the examiners, and the officers of the bank for a period of several years. No attempt was made to prove that the officers of the bank attempted to conceal from the Comptroller any fact or circumstance with regard to its condition, or the nature of its loans, or the solvency of its borrowers. It is not until the report of September 21, 1926, that any suggestion is made by the Comptroller or the examiners of any impairment of capital, and then the Chief Examiner Harris states that while the officers of the bank had not concurred in the classification he had made, yet as he saw the situation, "*estimated* losses impair your capital in the sum of $237,460.78." It is, of course, the desire of the Comptroller of the Curency that every

national bank have its assets in a liquid condition so that it may be able to meet not only the ordinary demands of business, but that in time of financial depression it may be able to readily turn them into cash. This, however, is an ideal and can never be completely attained. It is likewise self-evident that where a nation or community has undergone a period of tremendous inflation of values and suffered a subsequent deflation in values, in practically every bank which is serving its community as a reservoir of credit a large amount of slow or frozen assets will accumulate, a portion of which, in the gradual process of deflation, may become doubtful and finally result in loss. The fact that a bank has a large amount of slow paper would not justify the examiner or the comptroller in directing them to be charged off as losses or in warranting a court to determine them as losses without the aid of extrinsic evidence of the solvency of the borrower in each case. Until the insolvency of the borrower is actually determined, classification of his paper as doubtful or as a probable loss is purely a question of opinion and judgment. It may well be, as has transpired in the case of the Northwestern National Bank, that the recovery upon items classified as slow or doubtful, or even bad, may be vastly greater than the comptroller or the outside banker who makes a hurried survey would have thought possible. The Comptroller may, in the exercise of his sound discretion, demand of the stockholders of a bank that they remove from its assets any item or any number of items which in his judgment are so slow of liquidation as to make them non-bankable; that is—not suf-

ficiently liquid to warrant their continuation as part of the loans and discounts of a banking institution, but that is far from a determination that the items constitute losses or that they were the result of negligence or mismanagement on the part of the directors. Until such time as the directors, acting honestly, come to the conclusion that a given loan or discount represents a loss to the bank, or until such time as they are directed by the Comptroller to remove such loan or discount from its assets, they are justified in scheduling the items in question as a part of the bank's property.

Counsel has cited the case of

> *Thomas v. Taylor,* 224 U. S. 73, 56 L. Ed. 673, 676, 677

as authority for holding these defendants liable. An examination of that decision will show its utter inapplicability for the following reasons: In the first place, prior to the publication of the statement upon which the plaintiff there purchased his stock, the Comptroller had ordered the directors to charge off loans in the amount of $104,000, which they had failed and refused to do. The court held the directors in that case liable to the man who had purchased stock relying upon the statement as to the condition of the bank as shown by the published statement. We do not have such a condition here. The directors never declined or neglected to remove from the assets of the bank any item which the Comptroller directed should be done, and when the Comptroller suggested removing assets, were diligently

engaged under his direction and with his approval, in carrying out a plan which would comply with his request. Not only that but in the early part of 1927, a time when counsel contends the entire capital stock, surplus and undivided profits had been wiped out, the defendant Pittock, who had full knowledge of the condition of the bank, purchased stock from Lindner at the price of $120.00 per share.

Again, neither Burckhardt nor Ballin purchased stock relying upon any statement to the Comptroller, or published in the newspapers, or upon any representation of any of these defendants that was false, fraudulent or misleading. Nor if they had so done could they maintain this suit. They here sue not only for themselves, but for the benefit of all other stockholders in the bank. The action would be one of fraud or deceit. It is a personal action for damages at law and not one which can be maintained on behalf of a complainant for himself and the association or other stockholders or depositors.

Chesbrough v. Woodworth, 244 U. S. 72, 61 L. Ed. 1,000.

Benton v. Deininger, 21 Fed. (2d) 657.

It had been contemplated before the discovery of the Wheeler float that $1,500,000 worth of the slow assets of the bank be removed by the formation of a corporation whose stockholders should be stockholders in the bank. The discovery of the Wheeler float made this plan impracticable and a one hundred per cent. stock assessment the only feasible way to rehabilitate

the bank to the satisfaction of the Comptroller. On March 18, 1927, as shown by the letter to the Comptroller quoted on page 31 of appellants' brief, the directors stated: "The payment of an assessment of 100% has been guaranteed by certain responsible shareholders, a copy of which guaranty is submitted herewith."

Complainants make much of the testimony given by Mr. Ainsworth and Mr. Dick that in the hurried examination which they made at the time of the run, in their judgment it would have taken four million and a half to six million four hundred thousand dollars to have rehabilitated the bank's condition. It is to be remembered, however, that this examination was made in an emergency without opportunity to make detailed examination into the assets of the bank, *and was made with a view of taking over the entire deposit liability and being prepared to pay it out over the counter to the depositors who as a result of the run were demanding payment.* That these figures were entirely inaccurate is shown by the testimony which demonstrated that not only was it unnecessary to call upon the directors to make good their $2,000,000 guaranty but that it was not necessary for the Comptroller to make a stock assessment, and that the assets of the bank, as found by the trial court, will be sufficient to liquidate all of the bank's obligations.

A sound and reasonable test to be applied to the acts of bank directors is prescribed in Swentzel v. Penn Bank, 147 Penna. 140, 15 L. R. A. 305;

"It cannot be the rule that the director of a bank is to be held to the same ordinary care that he takes of his own affairs. He receives no compensation for his services. He is a gratuitous mandatary. His principal business at the bank is to assist in discounting papers, and for that purpose he attends at the bank at stated periods—generally once or twice a week—for an hour or two. The condition of the bank is then laid before him in order that he may know how much money there is to loan. Once or twice a year there is an examination of the condition of the bank in which he participates. The cash on hand is counted, the bills receivable and securities examined, to see whether they correspond with the statement as furnished by the officers. Beyond this he has little to do with either the cash or the books of the bank. They are in the care of salaried officials, who are paid for such services, and selected by reason of their supposed integrity and fitness. To expect a director, under such circumstances, to give the affairs of the bank the same care that he takes of his own business, is unreasonable, and few responsible men would be willing to serve upon such terms. In the case of a city bank, doing a large business, he would be obliged to abandon his own affairs entirely. A business man generally understands the details of his own business, but a bank director cannot graps the details of a large bank without devoting all his time to it, to the utter neglect of his own affairs. * * * In Spering's App., 71 Pa. 11, the subject is very fully discussed by the late Justice Sharswood, and the rule of ordinary care

is laid down. Not, however, the ordinary care which a man takes of his own business, *but the ordinary care of a bank director in the business of a bank.* Negligence is the want of care according to the circumstances, and the circumstances are everything in considering this question. The ordinary care of a business man in his own affairs means one thing, and the ordinary care of a gratuitous mandatary is quite another matter. The one implies an oversight and knowledge of every detail of his business; the other suggests such care only as a man can give, in a short space of time, to the business of other persons from whom he receives no compensation. The same learned judge, in Maisch v. Savings Fund, 5 Phila. 30, laid down the rule as follows: 'As to the directors, however, * * * receiving no benefit or advantage, they can be considered only a gratuitous mandataries, liable only for fraud or such gross negligence as amounts to fraud.'

"Again, in Spering's Appeal, supra, he said: 'Indeed, as the directors are themselves stockholders, interested as well as all others that the affairs and business of the corporation should be successful, when we ascertain and determine that they have not sought to make any profit not common to all the stockholders, we raise a strong presumption that they have brought to the administration their best judgment and skill.' * * *

"In regard to what is ordinary care, regard must be had to the usages of the particular business. Thus, *if the director of a bank performed his duties as such*

in the same manner as they were performed by all other directors of all other banks in the same city, it could not fairly be said that he was guilty of gross negligence; and *care must be taken that we do not hold mere gratuitous mandataries to such a severe rule as to drive all honest men out of such positions.* This thought is so well expressed by Sir George Jessel, M. R., in his opinion in Re Forest of Dean Coal Min. Co., L. R. 10, Ch. Div. 450, that I give his remarks in full: 'One must be very careful, in administering the law of joint stock companies, not to press so hard on honest directors as to make them liable for those constructive defaults, the only effect of which would be to deter all men of any property, and perhaps all men who have any character to lose, from becoming directors of companies at all. On the one hand I think the court should do its utmost to bring fraudulent directors to account; and, on the other hand, should also do its best to allow honest men to act reasonably as directors. Willful default no doubt includes the case of a neglect to sue, though he might, by suing earlier, have recovered a trust fund; in that case he is made liable for want of due diligence in his trust. But I think directors are not liable on the same principle'."

Again, in the case of Devlin v. Moore, 64 Ore. 433, 462, the duties of a director are epitomized as follows:

"10. As a general rule, directors are charged with the duty of reasonable supervision over the affairs of the bank. It is their duty to use ordinary diligence

in ascertaining the condition of its business and to exercise reasonable control and supervision over its affairs. They are not insurers or guarantors of the fidelity and proper conduct of the executive officers of the bank and are not responsible for losses resulting from their wrongful acts or omissions, provided they have exercised ordinary care in the discharge of their own duties as directors.

"11. Ordinary care, in this matter as in other departments of law, means that degree of care which prudent and diligent men would ordinarily exercise under similar circumstances. The degree of care required further depends upon the subject to which it is to be applied, and each case must be determined in view of all the circumstances of that particular case. If nothing has come to the knowledge to awaken suspicion that something is going wrong, ordinary attention to the affairs of the institution is sufficient. If, on the other hand, directors know, or by the exercise of ordinary care should have known, any facts which would awaken suspicion and put a prudent man on his guard, then a degree of care commensurate with the evil to be avoided is required, and a want of that care makes them responsible. Directors cannot, in justice to those who deal with the bank, shut their eyes to what is going on around them. Directors are not expected to watch the routine of every day's business, but they ought to have a general knowledge of the manner in which the bank's business is conducted, and upon what securities its larger lines of credit are given, and generally to know of

and give direction to the important and general affairs of the bank. They are not required to be bookkeepers.

"12. It is incumbent upon bank directors in the exercise of ordinary prudence and as a part of their general supervision to cause an examination of the condition and resources of the bank to be made with reasonable frequency. Rankin v. Cooper (C. C.), 149 Fed. 1010, 1013. See, also, Campbell v. Watson, 62 N. J. Eq. 396 (50 Atl. 120).

"13. To render directors or other officers of a corporation liable to it for the fraudulent or wrongful acts of other officers, they must have participated therein, or else they must be chargeable with culpable negligence. Clark & Marshall, Private Corporations, Vol. 3, p. 2279, Par. 751; Briggs v. Spaulding, 141 U. S. 132 (11 Sup. Ct. 924; 35 L. Ed. 662).

"14. If a director performs his duty as such in the same manner as such duties are ordinarily performed by all other directors of all other banks of the same city, it cannot be fairly said that he was guilty of gross negligence. Swentzel v. Penn. Bank, 147 Pa. 140 (23 Atl. 405, 415: 15 L. R. A. 305: 30 Am. St. Rep. 718, 722); Bolles, Modern Law of Banking, p. 280; Spering's appeal, 71 Pa. 11, 21 (10 Am. Rep. 684).

"15. The president, cashier, and other employees of the bank, although selected by the directors, are not the agents or servants of the directors, but of the corporation. Briggs v. Spaulding, 141 U. S. 132 (11 Sup. Ct. 924; 35 L. Ed. 662); Wallace v. Lincoln

Savings Bank, 89 Tenn. 630 (15 S. W. 448: 24 Am. St. Rep. 625; Morawetz, Private Corporations, Par. 552, et seq."

A particularly instructive case is that of Williams v. Fidelity Loan and Savings Company, 142 Va. 43, 128 S. E. 615, 45 A. L. R. 664, because it deals with loans, made during the same period of inflation, which, as a result of the subsequent deflation, became practically worthless. The Court holds that errors in judgment do not render directors liable. In the note found at page 683 the cases are collated, sustaining this rule of law, to which there does not seem to be any exceptions. See, also, American Savings Bank and Trust Company v. Earles, 113 Wash. 629, 194 Pac. 555.

We find on pages 110 and 111 of plaintiffs' brief, quotations from the opinion of the District Judge in the case of Bates v. Dresser, et al, 229 Fed. 798 as supporting complainants' contention that the directors are liable for negligence in not ascertaining the existence of the Wheeler float. This case was appealed to the Circuit Court of Appeals (250 Fed. 525). From that decision an appeal was taken to the Supreme Court of the United States, which rendered its opinion in Volume 251 U. S. at page 524, 64 L. Ed. 388. The District Court held all of the directors liable for the loss occasioned by the dishonesy of one of the bank's employees, on the ground that if they had made a check of the records they would have made an early discovery of the defalcation.

By a strange oversight, counsel has overlooked the fact that except as to the defendants Dresser, who had

been repeatedly warned of the employee's dishonesty, the decree of the lower court was reversed in toto, and that this action of the Circuit Court of Appeals was sustained by the Supreme Court of the United States. The Circuit Court of Appeals specifically declined to apply the test of liability laid down by the District Court, and we take the liberty of quoting at length from this decision:

> "The negligence of the defendant directors, because of which the court has found them liable, is therefore not any failure in duty on their part before September 30, 1907. It consists wholly in their failure, on or after that date, to discover that Coleman was practicing his method of stealing the bank's funds and was so manipulating the entries on its depositors' ledger from time to time, as to prevent their showing what he had done or was doing, except by resort to a more thorough and searching examination and checking of said entries than any which had ordinarily been made by the directors. * * * If negligence, as above appears, is not chargeable to the directors in respect of any of Coleman's stealings before September 30, 1907, it follows that they cannot be held responsible merely because of the deficiencies permitted by Earl to exist in the methods or routine followed in conducting the bank's regular operations or in recording them on its books, notwithstanding that it was by taking advantage of such deficiencies that Coleman was able to accomplish and conceal his stealings. They are entitled to rely, as they did, upon Earl to guard against any such deficiencies, and until some

special necessity for such action was brought to their attention they were under no duty to inquire or interfere independently of him.

> Briggs v. Spaulding, 141 U. S. 132, 165, 166; Warner v. Penoyer, 91 Fed. 587, 590, 591, 44 L. R. A. 761.

* * * * * *

The court found that no examinations (by the directors) except the two shown by the records as above, were made in 1907, 1908, or 1909.

* * * * No directors' examination, whenever or however made, having before extended to such verification of the figures found on the depositors' ledger as, in the view of the court, was necessary to an adequate performance of the directors' duties, it results that the real inquiry is whether their failure to make the kind of examinations and comparisons deemed necessary by the court, on September 30, 1907, was a failure in duty on their part so clearly negligent as to warrant the court in rejecting the master's findings, and to render the directors all responsible for the subsequent losses by Coleman's stealings. If not so liable as of that date, it is plain they are not so liable for the subsequent failures to make like examinations before each dividend subsequently declared.

"To hold all of the directors chargeable with negligence rendering them all so responsible, merely because they failed to make the additions and comparisons held necessary by the court, requires, in our opinion, the application of a standard of diligence

more exacting than any heretofore applied in the case of national bank directors; nor can we regard application of such a rule as justified by the circumstances here shown.

"We do not think it can be said that there would necessarily have been a negligent breach of duty on the part of every director, had examinations in accordance with Article 19 of the By-laws been wholly omitted during the period here involved; no special reason tending to forbid such omission being shown.
* * * *

" * * * We see no reason to doubt that the requirements of Article 19 might have been waived, their observance omitted by the directors, if regarded by them as no longer necessary, in the absence of special circumstances showing such waiver or omission to have been inconsistent with good judgment and reasonable prudence. Non-observance of a similar By-law for fourteen years appeared in the above case of Briggs v. Spaulding; the matters covered by it having been left by the directors wholly to the president and cashier and without any formal amendment or repeal of the By-law. The directors were nevertheless exonerated although stringent observance of the by-law could hardly have failed to have disclosed the misdoings of the president and cashier for which it was sought to hold them responsible. It was considered sufficient by the courts that the manner of conducting the bank's business in that and other respects had been sanctioned by long-continued usage. * * *

"Nor can we find negligence on the directors' part clearly and unmistakably shown merely by the fact that they omitted to make the examination in the particular way which the District Court regarded as a necessary test required by ordinary considerations of precaution. It is difficult to see upon what principle a director can be held negligent merely for omission to perform an act not usual and not known by him to be necessary or important, especially in the absence of anything suggesting inquiry as to its necessity or importance. What was regularly done at the examinations made appears from the quotation in the opinion below from the master's report; and it proved insufficient for the purpose of bringing to light that which would have led to discovery of Coleman's practices in that, as the opinion below states, 'they took the amount due to the depositors on the cashier's ledger as correct, which was in fact incorrect by the amount of Coleman's stealings.' Speaking generally of the directors, there had been nothing to put them on inquiry or cause them to suspect that the amount shown by the cashier's ledger as due depositors might be inaccurate and might therefore require verification by such additions of figures on the depositor's ledger, and we cannot hold their reliance upon the cashier and his ledger for a correct showing of said amount to have been clear and unmistakable negligence. The amount so taken by them as correct, as the master found, would be and apparently was verified by the cashier's showing of expenses paid, investments made, cash on hand and deposited with other banks.

"As, in view of Briggs v. Spaulding, 141 U. S. 132, above cited, we could not hold mere non-observance of the by-law to be a proved failure in performance of a duty required of the defendants as directors, we cannot hold the above failure on their part to go behind the figures given them by the cashier on his ledger of itself to be a proved negligent failure in due performance of their duties. Such action on their part would have been 'a measure of unusual precaution, not imperative when there was no reason to distrust the integrity or efficiency of the cashier'; and directors, as has been held, are 'not to be deemed remiss because they did not resort to exceptional methods, or because they relied upon the cashier's supervision over the books and accounts or because they reposed confidence in his reports of the amount and other clerical details of the assets and liabilities.' Warner v. Penoyer, 91 Fed. 587, 591.

"If any examination of the bank by the national examiners has since been made to appear in any respect inadequate in the light of the discoveries made as above by the expert accountant, each of them appears to have been at any rate much more thoroughgoing than any of the directors could have been expected to make without expert assistance. That such examinations were made twice in each year, and without discovering anything wrong in the bank's condition or bookkeeping, the directors knew, and that fact affords still another reason for believing that they were going along under a feeling of security, and with no cause to suspect wrongdoing or irregularities;

a reason which tends to forbid the conclusion that the directors are shown to have clearly and unmistakably failed in the ordinary care due from them, merely by their omission as above to make more regular and more searching examinations themselves.

"Nothing in the evidence tends to show that the examinations of the kind held necessary by the court are, or have ever been, usually recognized or understood as part of the regular duties which directors of such a bank as this are expected to perform, nor is any such duty required by any rule of law. Judging these directors as they are entitled to be judged, in the light of all the circumstances present to their minds at the time, as businessmen of average business abilities and accomplishments, with no pretensions to instinctive foresight or expert training in respect to bank bookkeeping, we are unable to believe that their omission to make such examinations on September 30, 1907, or thereafter, in the absence of notice of special necessity therefor, clearly proves negligence on their part. * * * Under a familiar principle in determining the question whether evidence was so clear as to justify rejecting the master's findings against negligence, reference must be had to the situation which surrounded the directors at the time of the alleged omissions of duty and before the wrongs of Coleman had been discovered and exposed, rather than by reference to the situation afterwards discovered and exposed by experts. 1 Thompson on Law of Negligence, Par. 28. The character of after-discovered conditions might be such in a given case as to tend to show negligence, yet fall short of making it

clear and unmistakable; and again, they might be such as to have very little, if any tendency to show negligence."

Upon this same subject the Supreme Court of the United States, on the appeal, said, 251 U. S. 528:

"In this connection it should be mentioned that in the previous semi-annual examinations by national bank examiners nothing was discovered pointing to malfeasance. The cashier was honest and everybody believed that they could rely upon him, although in fact he relied too much upon Coleman, who also was unsuspected by all. If Earl had opened the envelopes from the clearing house and had seen the checks, or had examined the deposit ledger with any care he would have found out what was going on. The scrutiny of anyone accustomed to such details would have discovered the false additions and other indicia of fraud that were on the books. But it may be doubted whether anything less than a continuous pursuit of the figures through pages would have done so except by lucky chance. The question of the liability of the directors in this case is the question of whether they neglected their duty by accepting the cashier's statement of liabilities and failing to inspect the depositors' ledger. The statements of the assets always were correct. A by-law that had been allowed to become obsolete, or nearly so, has been invoked as establishing their standard of conduct. By that a committee was to be appointed every six months 'to examine into the affairs of the bank, to count its cash, and to compare its assets and liabilities with the balances on the gen-

eral ledger for the purpose of ascertaining whether or not the books are correctly kept and the condition of the bank in a sound and solvent condition.' * * * We are not prepared to reverse the finding of the master in the Circuit Court of Appeals that the directors should not be held answerable for taking the cashier's statement of liabilities to be correct as the statement of assets always was. If he had not been negligent without their knowledge it would have been. *Their confidence seemed warranted by the semi-annual examinations by the government examiner,* and they were encouraged in their belief that all was well by the president, whose responsibility as an executive officer, interest as large stockholder and depositor, and knowledge from long daily presence in the bank, were greater than theirs. They were not bound by virtue of the office gratuitously assumed by them to call in the passbooks, compare them with the ledger, and, until the event showed the possibility, they hardly could have seen that their failure to look at the ledger opened the way to fraud. See, Briggs v. Spaulding, 141 U. S. 132, 35 L. Ed. 662; Warner v. Penoyer, 44 L. R. A. 761, 91 Fed. 587."

It is to be remembered that the national bank examiners examined the Northwestern National Bank in the month of September, 1926, at a time when the Wheeler float was reaching stupendous proportions, and yet the existence of the float was concealed from the national bank examiners as it was concealed from the examining committee by removing the dishonored McCormick Lumber Company checks from "cash items" and substituting new checks which were then sent for collection

to the eastern banks upon which they were drawn, and thus concealed in "items in transit".

Again, counsel quotes from Briggs v. Spaulding, 141 U. S. 168 (Brief, page 116), but with a degree of negligence far less excusable than that with which he charges the defendants in this case, counsel for the complainants *neglects to inform the Court that he is quoting from the* DISSENTING OPINION *and not from the opinion of the Court.*

The law laid down by the Supreme Court in Briggs v. Spaulding, and which has never been reversed, is as follows:

> "The performance of acts which are illegal or prohibited by law may subject the corporation to a forfeiture of its franchises, and the directors to criminal liability; but this would not render them civilly liable for damages. The liability of directors to the corporation for damages caused by unauthorized acts rests upon the common-law rule which renders every agent liable who violates his authority to the damage of his principal. A statutory prohibition is material under these circumstances merely as indicating an express restriction placed upon the powers delegated to the directors when the corporation was formed.'
>
> "It is perhaps unnecessary to attempt to define with precision the degree of care and prudence which directors must exercise in the performance of their duties. The degree of care required depends upon the subject to which it is to be applied, and each case has to be determined in view of all the circumstances.

They are not insurers of the fidelity of the agents whom they have appointed, who are not their agents but the agents of the corporation; and they cannot be held responsible for losses resulting from the wrongful acts or omissions of other directors or agents, unless the loss is a consequence of their own neglect of duty, either for failure to supervise the business with attention or in neglecting to use proper care in the appointment of agents. Morawetz, Par. 551, et seq., and cases.

"*Bank directors are often styled trustees, but not in any technical sense. The relation between the corporation and them is rather that of principal and agent,* certainly so far as creditors are concerned, between whom and the corporation the relation is that of contract and not trust. But, undoubtedly, under circumstances, they may be treated as occupying the position of trustees to cestui que trust.

"In Percy v. Millaudon, 8 Mart. N. S. 68, which has been cited as a leading case for more than sixty years, the Supreme Court of Louisiana, through Judge Porter, declared that the correct mode of ascertaining whether an agent is in fault 'is by inquiring whether he neglected the exercise of that diligence and care, which was necessary to a successful discharge of the duty imposed on him. That diligence and care must again depend on the nature of the undertaking. There are many things which, in their management, require the utmost diligence, and most scrupulous attention, and where the agent who undertakes their direction renders himself responsible

for the slightest neglect. There are others where the duties imposed are presumed to call for nothing more than ordinary care and attention, and where the exercise of that degree of care suffices. The directors of banks, from the nature of their undertaking, fall within the class last mentioned, while in the discharge of their ordinary duties. It is not contemplated by any of the charters which have come under our observation, and it was not by that of the Planters' Bank, that they should devote their whole time and attention to the institution to which they are appointed, and guard it from injury by constant superintendence. Other officers on whom compensation is bestowed for the employment of their time in the affairs of the bank have the immediate management. In relation to these officers, the duties of directors are those of control, and the neglect which would render them responsible for not exercising that control properly must depend on circumstances, and in a great measure be tested by the facts of the case. If nothing has come to their knowledge, to awaken suspicion of the fidelity of the president and cashier, ordinary attention to the affairs of the institution is sufficient. If they become acquainted with any fact calculated to put prudent men on their guard, a degree of care commensurate with the evil to be avoided is required, and a want of that care certainly makes them re-responsible."

The Supreme Court then proceeds to quote with approval the language of Lord Hatherley in Land Credit Co. of Ireland v. Fermoy, L. R. 5 Ch. 763:

"Whatever may be the case with a trustee, a director cannot be held liable for being defrauded, to do so would make his position intolerable."

The Court then goes on to say:

"The doctrine that one trustee is not liable for the acts or defaults of his co-trustees, and while, if he remains merely passive and does not obstruct the collection by a co-trustee of moneys, is not liable for waste, is conceded, but it is argued that if he himself receives the funds, and either delivers them over to his associate, or does any act by which they come into the possession of the latter or under his control, and but for which he would not have received them, such trustee is liable for any loss resulting from the waste (Bruen v. Gillet, 115 N. Y. 10, 4 L. R. A. 529; Pomeroy, Eq. Jur. Par. 1069, 1081); and that this case comes within the rule as thus qualified."

"Treated as a cause of action in favor of the corporation, a liability of this kind should not lightly be imposed in the absence of any element of positive misfeasance, and solely upon the ground of passive negligence; and it must be made to appear that the losses for which defendants are required to respond were the natural and necessary consequences of omission on their part. * * *

"Nor was there any violation of law in permitting him to conduct its business, for he was duly authorized to do so under the provisions of the Act. We do not mean that this dispensed with reasonable oversight by the directors, but that belongs to a different branch of inquiry."

"But it is contended that defendants should have insisted on meetings of the board of directors or had special meetings called, and at those meetings or otherwise made personal examination into the affairs of the bank, and that had they done this they would have discovered the condition of the bank and prevented losses occurring subsequently to the 10th of January.

"Here, again, it should be observed that even trustees are not liable for the wrongful acts of their co-trustees unless they connive at them or are guilty of negligence conducive to their commission, and that Lee and Vought had long been directors. * * *

" * * * We are impressed by the evidence with the conviction that a cursory glance would not have been enough. * * *

"*Certainly it cannot be laid down as a rule that there is an invariable presumption of rascality as to one's agents in business transactions, and that the degree of watchfulness must be proportioned to that presumption.* 'I know of no law' said Vice Chancellor McCoun, in Scott v. Depeyster, 1 Edw. Ch. 541, 6 L. Ed. 239, 'which requires the president or directors of any moneyed institution to adopt a system of espionage in relation to their secretary or cashier or any subordinate agent, or to set a watch upon all their actions. While engaged in the performance of the general duties of their station, they must be supposed to act honestly until the contrary appears; and the law does not require their employers to entertain jealousies and suspicions without some apparent reason. Should any circumstance transpire to awaken a just suspicion of their want of integrity, and it be

suffered to pass unheeded, a different rule would prevail if a loss ensued; but, without some fault on the part of the directors, amounting either to negligence or fraud, they cannot be liable.'

"Nor is knowledge of what the books and papers would have shown to be imputed. In Wakeman v. Dalley, 51 N. Y. 32, Judge Earl observed in relation to Dalley, sought to be charged for false representations in the circular of a company of which he was one of the directors: 'He was simply a director, and as such attended some of the meetings of the board of directors. As he was a director, must we impute to him, for the purpose of charging him with fraud, a knowledge of all the affairs of the company? *If the law requires this, then the position of a director in any large corporation, like a railroad, or banking, or insurance company, is one of constant peril.* The affairs of such a company are generally, of necessity, largely intrusted to managing officers. The directors generally cannot know, and have not the ability or knowledge requisite to learn by their own efforts, the true condition of the affairs of the company. They select agents in whom they have confidence, and largely trust to them. They publish their statements and reports, relying upon the figures and facts furnished by such agents; and if the directors, when actually cognizant of no fraud, are to be made liable in an action of fraud for any error or misstatement in such statements and reports, then we have a rule by which every director is made liable for any fraud that may be committed upon the company in the abstraction of its assets and diminution of its capital by any of its

agents, and he becomes substantially an insurer of their fidelity. It has not been generally understood that such a responsibility rested upon the directors of corporations, and I know of no principle of law or rule of public policy which requires that it should'."

Counsel also cites Chesbrough v. Woodworth, 195 Fed. 881. This case was appealed to the Supreme Court of the United States and was reported in 244 U. S. 72, and 61 L. Ed. 1,000. It has no application to the facts in the case at bar. It was an action at law brought by stockholders *who had purchased their stock relying upon the published statement of the condition of the bank made prior to the time of their purchase,* wherein the directors carried as assets paper of the Maltby Lumber Company twenty times greater than the amount which could be loaned under the law. Neither of the complainants here bought their stock relying upon any statement, published or otherwise, which was false or misleading, and has been pointed out before, they could not prosecute such a claim in this kind of a proceeding. The Court plainly stated: *"The damages in such a case are personal to the plaintiff. He sues in his own right and not for the association."*

Counsel also cites Jones National Bank v. Yates, 240 U. S. 559, 56 L. Ed. 788. In this action it was sought to hold the directors severally liable *to depositors who suffered damages* because of the false representations as to the bank's financial condition. It was there held that in such an action the testimony must prove that the violation of the statute with regard to financial reports must have been knowingly done and hence that

'something more than negligence is required; that is, the violation must in effect be intentional". Again we state that it is not claimed that the complainants were depositors who suffered any loss by reason of any statements made by the board of directors, nor is there any evidence that the statements made were false, let alone that they were knowingly false.

The decision in Bowerman v. Hammer, 250 U. S. 510, in no wise enlarges the liabilities or increases the duties of directors as defined in Briggs v. Spaulding, Rankin v. Cooper, and Bates v. Dresser, heretofore mentioned. Bowerman had been elected a director of the bank and had not attended a single meeting of the board of directors and wholly abrogated the duty of supervision and control which rested upon him as a director. The court therefore properly held that he was guilty of common law negligence and that his claimed ignorance as to the bank's condition was the result of gross inattention in the discharge of his voluntarily assumed and sworn duty. These defendants not only attended the regular and special meetings of the board of directors but freely and continuously gave their time and attention to the bank's affairs and unless they are to be held liable for lack of omniscience and instinctive foresight, they cannot be here held liable.

We find it necessary to correct certain statements of counsel with regard to the Wheeler float. On page 51 of his Brief, he relates the testimony of the witness Decker, who had charge of the collection department of the bank, that when the examining committee was looking into the bank's condition the cash items were listed

in the usual way and were handed over to Mr. Fraley, the auditor, that he might go over them with the examining committee. Counsel has overlooked the fact that when the examining committee came into the bank to make their required examinations, the McCormick items had been removed from the cash items and that new checks of the McCormick Lumber Company deposited in lieu thereof, which were then in "items in transit", unsegregated, unnamed, and there was no means whereby the examining committee could ascertain their existence except by writing to their correspondent banks through whom they had been sent for collection, and that neither Decker, Young, Fraley, or any officer or employee of the bank ever informed the members of the examining committee of the existence of such items or the fact that the McCormick Lumber Company items were continually being dishonored. The examining committee did, however, follow the practice of obtaining letters of verification that the gross amount of items claimed to have been sent to them and in transit on the day of the examination had in fact been so sent. Indeed, unless the attention of the examining committee was specifically invited to the fact that this course of crediting checks which would ultimately be dishonored was in existence, no check or audit, unless it be a continuous one over a long period of time, would have revealed its existence. Wheeler and Olmstead concealed this practice not only from the examining committee but also from the national bank examiners when their official examinations were made.

On page 84 of complainants' brief, counsel requests the court to note, and has italicised, an extract from the Wilde report of March 25, 1926, that "The McCormick Lumber Company protested checks, and Wheeler-Olmstead Company protested checks, both carried as cash items, were eliminated during the examination, having been taken up by J. E. Wheeler and the McCormick Lumber Company." These items, however, were not a part of the so-called float but were checks of the two companies in question which had been deposited to the account of J. E. Wheeler and, as the examiner states, had been taken up during the examination by Mr. Wheeler and by the McCormick Lumber Company. It is fair to assume that if those matters were indicative of dishonesty or violation of the banking laws, the examiner in question would have plainly so stated and directed the attention of the board of directors thereto.

On page 85 is the statement that the auditor of the bank, Fraley, called the attention of the examining committee to the very things alleged in the complaint. If counsel by that refers to the McCormick Lumber Company float, we have this to say: that the testimony does not contain any such statement from the lips of Fraley, or any other witness.

Counsel has attempted to make capital out of the fact that the bank published the report of its condition in the month of March, 1927, and at approximately the same time wrote the Comptroller admitting a total impairment of capital.

As we have indicated before, even though this were true, it would avail the complainants nothing for the

reason that they neither bought stock nor suffered a deposit loss by reason of such statements.

As a matter of fact, however, there is no actual discrepancy between the published statement and the letter to the Comptroller. The report of the Examiner showing the impairment did not take into consideration the one hundred percent assessment which had been guaranteed by responsible and substantial stockholders, while the published report gave due and proper consideration to that fact.

Therefore the payment of an assessment of one hundred per cent. on the capital stock having been guaranteed by responsible stockholders, the board of directors were justified in their pubilshed statement in March of an unimpaired capital.

On page 87 we find the capitalized statement that every one of the defendants testified that the Wheeler matter was left to Olmstead. The evidence shows that the directors discussed the matter and instructed Olmstead to bend his efforts to liquidate the Wheeler indebtedness; that director Collins personally conferred with Olmstead and Wheeler upon the matter and that the Wheeler line of credit received continuous general consideration from the board of directors at practically every one of its meetings.

On page 95 is found the statement that "while knowing and having cause to inquire for further knowledge, they allowed cash items of more than two hundred thousand dollars in July, 1926, as fictitious credits in the transactions of the bank, to which the attention of Price was then specifically drawn, to grow and increase

through August and the rest of the summer until Skinner's previous, as well as his specific attention on February 10, 1927, was directly called to about and over $800,000 of such cash items outstanding." There is not a shred of testimony showing knowledge on the part of any of the directors of such cash items with the exception of director Price, and that is specifically denied by Price and rests solely upon the unsupported word of Olmstead, and is so incredible, illogical and unlikely that it can have no probative weight.

Complainants specify error in the action of the court in quashing service of summons and dismissing the suits as to the defendant McCormick. The complainants are both non-residents of the District of Oregon. McCormick is a resident of Illinois and was there served with process. Under Section 51 of the Judicial Code, Sections 112 to 118 inclusive, U. S. C. A., no civil suit shall be brought in any district court against any person by any written process or proceeding in any other district than that whereof he is an inhabitant, but where jurisdiction is founded only on the fact that the action is between citizens of different states, suit shall be brought only in the district of the residence of either the plaintiff or defendant. As the trial court held, the sections in question "have reference to states containing more than one district, or containing more than one division, or where receivers are appointed of lands or other property of fixed character, or suits to enforce legal or equitable liens upon or claims to, or to remove an incumbrance or cloud upon the title of real or personal property within the district in which the suit is

brought. None of the cases cited by counsel have any applicability to proceedings such as these. These proceedings are based upon an alleged violation of either the common law or statutory duties of a director. There is no *res* involved; no property, either real or personal, which the court has any right to take possession of and administer. These suits, therefore, are not suits to enforce a lien on real or personal property, to remove a cloud of incumbrance thereon, but are *in personam.* If jurisdiction is asserted because a federal question is involved, then under the sections in question McCormick can be sued only in the district of which he is an inhabitant.

> Rose's Federal Procedure, 280;
> *Macon, etc., v. Atl. Coast Line,* 215 U. S. 501.

If jurisdiction is founded upon citizenship alone, the defendant McCormick cannot be compelled to submit himself to the jurisdiction of the District Court of Oregon in a suit brought by non-residents by serving him in the district of his own residence.

> *Camp v. Gress,* 250 U. S. 308;
> *Robertson v. Railroad Labor Board,* 268 U. S. 619, 69 L. Ed. 1119;
> Foster's Fed. Prac., 6th Ed., Sections 61-B and 61-C;
> Bunn, U. S. Courts, p. 117.

Not only has this specification no merit of its own but in view of the fact that the bill is without equity, it does not merit further consideration.

With all courtesy and consideration for counsel, we are compelled to say that much of the brief filed is taken up with matters the point of application of which we cannot understand. We have endeavored to sift out from the brief and from the record the actual issues of law and fact and to present them fairly and fully to the court.

The defendants in this case have never had any desire to, and know no reason why they should, conceal any fact, or seek to avoid any proper responsibility. In their long course as directors of the Northwestern National Bank they diligently and honestly endeavored to fulfill the duties which they assumed. The condition in which the bank found itself was in no manner the result of inattention, negligence, or mismanagement on their part. They had pursued a constructive policy with regard to the bank's affairs from the moment that deflation had "frozen" a substantial amount of the bank's loans and discounts. They had devoted every penny of the bank's earnings, which were large, to the removal of unsatisfactory assets and to writing off losses as and when they were ascertained.

When in the judgment of the Comptroller, it was thought wise to hasten the removal of "frozen" assets, under his direction and with his approval they had laid plans, and were actively engaged in their execution for the formation of a holding company which would not only take the non-income producing loans from the bank, but which would vastly increase its income. These plans would have been consummated and the bank would still be one of the active and prosperous banking

institutions of the northwest, had it not been for the criminal acts of Wheeler and Olmstead which brought about the Wheeler crash. The policy which the directors pursued had the approval of both the bank examiners and the Comptroller. It failed through no fault of theirs. Being unaccused by their own consciences of any fault other than possible errors in judgment, to which all mankind are prone, they confidently expect the affirmance of the decree of the trial court which after patiently giving to the complainants the utmost scope in the presentation of their evidence, acquitted these defendants of any wrong doing.

Respectfully submitted,

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